has been sanctioned by other agents of the Comptroller, the bank examiners, after the other contracting party has acted upon that assurance to his detriment. This extract from the opinion in *Brown v. Schleier, 118 Fed. 981*, affirmed *194 U. S. 18, 48 L. ed. 857*, is pertinent:

> "We think that, in virtue of his office as receiver, he is not authorized to challenge or impeach an executed transaction between the bank and a third party, that was simply ultra vires, and which, though known to the United States, through its proper officials, at the time it was undertaken and consummated, was neither arrested nor complained of by the United States or any creditor or stockholder of the bank."

When the receiver took charge of the First National Bank the pledge agreement had been performed by all parties except the bank's trust officer who held the liberty bonds as a trustee for the railway company. The bank had made the pledge and the Texas and Pacific had made the deposits; nothing remained to be done except the delivery by the trustee to the railway company of the liberty bonds to which it has shown itself justly entitled.

Seventh and Eighth Propositions

7. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, moneys thereafter deposited in reliance upon that security are received by the bank as special deposits which it holds in trust for the use and benefit of the depositor, and those deposits, or an equivalent sum of money, may be recovered in full from the bank or from its receiver into whose hands they passed upon the bank's failure.

8. When a solvent national bank induces a depositor to cancel and surrender corporate surety bonds protecting its deposits and to accept in lieu thereof other security which the bank is without authority to furnish, the courts will enforce an implied agreement on the part of the bank to return the moneys deposited with it in reliance upon the invalid security, and those deposits never become general assets of the bank which its subsequently appointed receiver may distribute ratably among the bank's unsecured creditors.

Scott v. Armstrong, 146 U. S. 499, 507, 510, 36 L. ed. 1062-1063; Central Transportation Co. v. Pullman Car Co., 139 U. S. 24, 60, 35 L. ed. 55, 69; Aldrich v. Chemical National Bank, 176 U. S. 618, 636, 44 L. ed.

611, 618; Citizens' National Bank v. Appleton, 216 U. S. 196, 206, 54 L. ed. 443, 446.

Argument Under Seventh and Eighth Propositions

The Circuit Court of Appeals has held that this is not a suit for benefits received, but one "upon a contract, to enforce it" (R. 125).

The amended bill of complaint (R. 1-20) substantially sets forth the matters incorporated in the foregoing statement of facts and contains an alternative plea to the effect that the railway company is entitled to recover from the receiver, as for money had and received, the full amount of its deposits in the First National Bank when it failed on September 4, 1931, if it is held that the pledge agreement is unenforceable (R. 10), and an alternative prayer for that relief (R. 12). If this Honorable Court should be of the opinion that the amended bill states only a cause of action upon the pledge agreement and if the Court should hold that such agreement is ultra vires and void and may be disaffirmed by the receiver, then your petitioner respectfully asks that such action of the Court be without prejudice to another cause of action by petitioner against the receiver for money had and received or for the recovery of or compensation for the money with which petitioner parted on the faith of the pledge agreement. *Central Transportation Co. v. Pullman's Car Co., 139 U. S. 24, 60, 35 L. ed. 55, 60;*

Pullman's Palace Car Co. v. Central Transportation Co., 171 U. S. 138, 43 L. ed. 108.

This Honorable Court in many decisions has held that even though a contract of a corporation be illegal and void, yet, if the other party thereto has actually performed it, in order to do justice between the parties, the courts will imply an agreement on the part of the corporation to return that which it has received by reason of the unlawful contract. We quote from a few of the leading cases to illustrate the rule:

Central Transportation Co. v. Pullman's Car Co., 139 U. S. at page 60, 35 L. ed. p. 69:

> "A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms, but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain".

Aldrich v. Chemical National Bank, 176 U. S. at page 636, 44 L. ed. p. 618:

> "Suppose a national bank, in violation of the act of Congress, takes as security for a loan made by it a deed of trust of real estate, and subsequently causes the property to be sold and the proceeds applied in payment of its claim against the borrower, a surplus being left in its hands, which it uses in its business or in the discharge of its obligations. If sued by the borrower for the amount of such surplus, could the bank successfully resist payment upon the ground that the statute forbade it to make a loan of money on real estate security? Common honesty requires this question to be answered in the negative".

Citizens' National Bank v. Appleton, 216 U. S. at page 206, 54 L. ed. p. 446. (after quoting from the Pullman Car case, first above cited):

> "We need not go farther. It is entirely clear that the judgment against the defendant bank * * * was consistent with sound legal principles and was intrinsically right, even if the guaranty in question was beyond the power of the guaranteeing bank, under the national banking statutes. Whatever may be said as to the written guaranty, now alleged to be illegal, the judgment can be supported as based wholly on the implied contract, which made it the duty of the Central National Bank, under the facts disclosed, to account to the Cooper Exchange Bank for the money obtained

from the latter in execution of the agreement made by the former with the borrower".

Although holding that this is not a suit for benefits (R. 125), the Circuit Court of Appeals in effect has held that the bank received no benefits which may be recovered. This it accomplished by finding and concluding that the contract of deposit contained two agreements, viz: "One that the bank should pay back to the railway upon demand the sums deposited with it as other general deposits were. * * * The other is an agreement for security" (R. 124), and by holding that the moneys deposited by the railway company in reliance upon the invalid pledge agreement became general deposits the title to which ipso facto passed to the bank (R. 124-125).

The relationship between banker and depositor is one voluntarily assumed and must rest upon some contract between the parties. *Ruling Case Law, Vol. 3, p. 518.* Therefore, "whether a deposit in a bank is general or special depends upon the contract resulting from the mutual understanding and intention of the parties at the time such deposit is made". *Northern Sugar Corporation v. Thompson (C. C. A. 8th Circuit), 13 Fed. (2d) at page 831.* This the Circuit Court of Appeals conceded (R. 125), but, citing as authority its opinion in *Fagan v. Whiddon, 57 Fed. (2d) 631,* the

Court held "an agreement definitely fixing the character of the deposit as general may not be disregarded because, if the depositor had fully known the law and the facts, he would have acted differently for his protection" (R. 125). In that case the executors of Whiddon sought to impress certain funds in the hands of Fagan, receiver of the First National Bank of Avon Park, Florida, with a trust to the extent of Whiddon's savings deposits in that bank. After making the deposits, which the Court stated created the relationship of debtor and creditor, Whiddon was adjudged insane and his guardians, later his executors, "undertook to ascertain the nature and condition of the accounts and business of their award with the bank, the deposits that he had there and the property they held for him, and made general and specific inquiries of the officers of the bank; they sought and obtained an inventory and specifically inquired whether Whiddon had a savings account" (p. 631). The inventory furnished showed no savings account, and "the officer to whom the inquiry was referred, having full knowledge that his statement was false, advised that Whiddon had no savings account" (p. 631). After Whiddon's death, his executors relied upon the statements and representations of the bank's officer that Whiddon carried no savings account in the bank, and they did not ascertain that he had one until the bank had been placed in the

hands of a receiver. Had they known of the existence of the savings account, Whiddon's executors would have withdrawn the money before the bank failed (p. 631). After finding these facts the master, to whom the case was referred, concluded that,—

> "since the result of the fraudulent acts and concealments of the bank and its officers, if given effect to, would be in effect to permit the bank to tender a now insolvent for a then solvent debtor, and thus defraud appellees of the moneys they would then have received, the matter must be looked on as though the deposit had in fact been withdrawn, the relation of debtor and creditor terminated, and a new relation of trustee for a special fund created" (pp. 631-632).

The judgment of the District Court, adopting the master's conclusions of law, was reversed by the Circuit Court of Appeals, with directions to dismiss the bill. In support of its decision, the latter Court stated:

> "All that has occurred here is that a debtor bank has put off payment of its debt until it has become unable to pay it, by falsely stating to the representatives of the depositor that the debt did not exist. False and reprehensible though this conduct was, and liable as its authors undoubtedly are for the damage which it caused, its factual and legal character and consequences cannot, be-

> cause insolvency has ensued, by any kind of equitable intendment be converted from the false statement that the debt did not exist, into the true statement that it did, and an agreement that it would be regarded as withdrawn as a general and redeposited as a special deposit to be held by the bank not as its own money, for the amount of which it stands debtor to the depositor, but as the depositor's money of which it is trustee" (p. 632).

In the Whiddon case, the character of the deposits when made was definitely fixed as general, about which no controversy arose, and the novation in law which the executors sought to establish arose out of circumstances occuring after the deposits were made. In the case at bar the character of the deposits depends upon an agreement antedating or contemporaneous with the deposits by which the Texas and Pacific agreed that they might be general provided they were secured. This is made clear by the District Court's findings of fact that the president of the railway company informed the bank's vice president-cashier "that under no circumstances would The Texas and Pacific Railway Company continue its account with and deposits in the First National Bank of El Paso without full and adequate security" (R. 90), and that the railway company, believing the representations of the bank's officers and attorneys that the pledge agreement and liberty bonds "would protect the deposits of The Texas and Pacific Railway Company in The First

National Bank of El Paso as fully and to the same extent as said corporate bonds", accepted the pledge agreement and those bonds, cancelled the surety bonds and thereafter continued its account with and made deposits in the First National Bank "relying upon said pledge agreement and liberty bonds as security for its deposits" (R. 92-93). To hold otherwise would mean that the railway company agreed to place its moneys in the First National Bank as general deposits even though the pledge agreement was invalid. Such is contrary to the record in this case.

In support of its position that the Texas and Pacific placed its moneys on general deposit, the Circuit Court of Appeals declared that the railway company "was as fully charged with knowledge as the bank was" of the latter's "want of power" to make the contract for security (R. 125). This conclusion, of course, is predicated upon the Court's prior finding that national banks can only exercise those implied powers which are "necessary (that is, indispensable) to the proper conduct of the business of a national bank" (R. 124). This, as we have shown in the preceding section of this brief, is not the proper measure of the implied powers of national banks. Those banks are expressly authorized to exercise all such incidental powers as shall be necessary—that is, convenient or useful[1]—to

[1] McCullough v. Maryland, supra, pages 42-44.

carry on the business of the bank, and what may be convenient or useful to it is purely a fact question peculiarly within the knowledge of the bank's officers. Moreover, "the mutual understanding and intention of the parties," *Northern Sugar Corporation v. Thompson*, supra, not the legal knowledge of the depositor, determines the character of the deposit, and since the Texas and Pacific required the bank to furnish corporate surety bonds for more than eight years and made it plain to the bank's officers when the pledge agreement was made that the railway company's account would be closed and its deposits withdrawn if they were not fully secured, it cannot be successfully contended that it was the mutual understanding and intention of the bank and the railway company that the title to the latter's deposits should vest in the bank if in fact the pledge agreement was void.

After January 29, 1931, when the liberty bonds were substituted for the surety bonds as security for its deposits, The Texas and Pacific Railway Company continued its account with and thereafter deposited in the First National Bank a total of $148,765.75 (R. 93), and at all times between January 29, 1931 and September 4, 1931, when the bank failed, the Texas and Pacific had an amount in excess of $50,000 on deposit (R. 47, 67, 81). At the close of the bank's business on August 6, 1931, the railway company had a balance of

$50,428.10, and it deposited an additional $16,545.48 between August 6 and September 3, 1931 (R. 84, 93). On the latter date the Texas and Pacific had $54,325.90 in the bank to which sum was added a small interest payment and an unpaid cashier's check, thus raising the total to $54,646.94 as of September 4, 1931 (R. 84-85, 93). All of those funds were deposited subsequent to January 29, 1931, the date on which the liberty bonds were substituted as security for the Texas and Pacific's deposits (R. 93), and the so-called "assets" of which the receiver took charge on September 8, 1931 (R. 48) included those funds.

It is true that the receiver is directed by section 192 of the National Bank Act to take charge of all the bank's "assets" etc. and to pay over to the Treasurer of the United States, subject to the order of the Comptroller, all moneys received from the collection of debts, claims, and the sale of property, and the Comptroller by section 194 is directed to make a "ratable dividend" from time to time, under certain conditions, of the moneys turned over to him by the receiver, but this Honorable Court has held that "the requirement as to ratable dividends, is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank" *Scott v. Armstrong, 146 U. S. at page 510, 36 L. ed. p. 1063.*

There is another aspect of this case which should not be overlooked. It is of record that the bank's vice president-cashier, who succeeded in getting the railway company to accept the pledge agreement and the liberty bonds in lieu of the corporate surety bonds, knew at the time he came to Dallas for that purpose that the Maryland Casualty Company, surety on one of the $25,000 bonds, intended to "get off" all bonds of the First National Bank; that the bank was "going to have to give up this Maryland Casualty bond"; that the railway company was being asked to accept the liberty bonds in lieu of the surety bonds partly because the bank knew that the Maryland Casualty Company would ask that the bond be canceled, or would not renew it; and that it was doubtful whether or not the bank could get a substitute standard surety company. But that bank official "did not mention" to the railway company's president "at the time this substitution was made, nor at any time thereafter, this substitution was desired on account of the surety company threatening to cancel its bonds. He never heard of that, so far as I know" (R. 63, 70-72). Had a full disclosure been made, the railway company would not have agreed to the cancellation of its surety bonds. Having obtained the railway company's deposits under these circumstances, which give rise to a constructive fraud, the Court should hold that the bank received them

as special deposits the title to which remained and now is in the railway company.

Since the First National Bank, if the pledge agreement be void, received the Texas and Pacific's deposits not as general but as special deposits, they never became the property of the bank which the receiver might distribute ratably to unsecured creditors, but the receiver took them as a part of the funds passing into his hands impressed with a trust in favor of the railway company.

Conclusion

As stated by Attorney General Gregory, "the power to receive deposits, expressly granted to every national bank * * * is, of course, indispensable to the conduct of banking, and the extent of its exercise is in a degree the measure of the success of the bank"; "the means by which depositors are to be protected and secured are not expressly limited or restricted by statute"; "a large discretion is left to the (bank's) officers and directors"; and "they may use such means for the purpose as are not prohibited by, or inconsistent with the provisions of, the law, and as they may reasonably find to be suitable and proper and not inconsistent with the prudent conduct of the affairs of the bank within the scope of its charter"[1]. That officers and directors of banks have availed themselves of this privilege is shown by the finding of the Supreme Court of Tennessee that the practice of giving security for deposits "is a practice followed by many banks", *Grigsby v. Peoples Bank, 158 Tenn. 193.*

The officers and directors of The First National Bank of El Paso, Texas, considered the exercise of that prerogative beneficial to the bank as shown by this record: Although admittedly solvent (R. 89), it became necessary for the First National to curtail expenses, including the premiums which it had been paying on the

1 Supra, pages 47-49.

surety bonds protecting the railway company's deposits (R. 64). In addition the Maryland Casualty Company, surety on one of those $25,000 bonds, had informed the officers of the bank that it was "going off" all bonds, and it was apparent the bank would experience difficulty in procuring a substitute surety company (R. 70-72). The bank's officers knew that the railway company with the cancellation of its bonds would close its account and withdraw its deposits (R. 90), and this they wished to avoid. They proffered to the Texas and Pacific a pledge of liberty bonds in lieu of the corporate surety bonds (R. 89), and, being unaware of the action of the Maryland Casualty Company the railway company, solely for the purpose of aiding the bank (R. 90), accepted the pledged liberty bonds, caused the surety bonds to be cancelled (R. 92-93), continued its account with the First National and thereafter deposited with it a total of $148,765.75 (R. 93).

This being true, we confidently believe this Honorable Court will find and hold (1) that the pledge of liberty bonds in lieu of the surety bonds as security for the railway company's deposits was a valid exercise by the First National Bank of a power incidental to its express power to receive deposits, (2) that the receiver may not disaffirm such pledge agreement, at least without returning or tendering to the Texas and

Pacific the full amount of its deposits made in reliance upon that agreement, and (3), in the alternative, that the railway company may recover from the receiver, as for money had and received which he holds in trust, the full amount of its deposits when the bank failed on September 4, 1931.

Wherefore, petitioner respectfully prays that this Honorable Court reverse the decree and judgment of the District Court and the Honorable Circuit Court of Appeals for the Fifth Circuit and remand this cause with direction to grant the relief sought by petitioner, that costs be taxed against respondent, and that such other orders and decrees be entered as to this Honorable Court petitioner may seem entitled in the premises.

Dated at Dallas, Texas, November 20, 1933.

Respectfully submitted,

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